THE SUNDAY TIMES

American Account: Fed's cheap cash lifts US out of spring swoon

Irwin Stelzer - Published: 28 April 2013

The US economy grew at an annual rate of 2.5% in the first quarter, well ahead of the paltry 0.4% in the final quarter of 2012. Consumer spending led the way, increasing at 3.2%. But leave the champagne on ice for now. Consumer outlays were boosted by involuntary spending on fuel during an unusually cold winter, and by one-time spending of the dividends that were paid out at the very end of last year rather than in 2013, when dividend income became subject to higher taxes.

Worse, it seems that consumers began reining in their spending in February and March. When they realised that the payroll tax increase effective at the beginning of the year was taking 2% out of their pay, they decided to take a pass on some of the offerings in Walmart, McDonald's and other stores that cater to less affluent shoppers. Meanwhile, families with annual incomes of more than $250,000 cannot help noticing that the president has taken aim at their dividend cheques, has loaded a new Obamacare tax onto them, and is now calling for an increase in the rate they pay on their ordinary income. The final straw is the realisation that Obamacare is driving up health insurance premiums, dictating more prudence when in the shopping centres.

A 2% payroll tax increase might not sound like a lot, but along with the rise in taxes on families earning more than $450,000 it has yanked $150bn out of consumers' pockets. Economists estimate this self-inflicted wound will cut a full percentage point off this year's growth.

There is real irony here. Republicans agreed to the tax raid on workers' pay while opposing the president's proposal for higher taxes on millionaires. They were joined by Democrats, who profess to be champions of the middle class, the very people hit hardest by this latest squeeze on take-home pay.

Not all of what pundits call the "spring swoon", the third successive April slowdown, can be blamed on the bipartisan decision to raise taxes. The world is indeed with us, not late and soon, but right now. The eurozone economy is contracting, and Wolfgang Schäuble, the German finance minister, has warned: "Nobody should think that Europe will deliver high growth rates in the coming years."

Unlike the American, Japanese, UK and other central banks, the European Central Bank is refusing to print money lest it antagonise the EU's paymaster-in-chief, German chancellor Angela Merkel. Although debt and unemployment levels in countries under the German-imposed austerity lash are soaring, Merkel remains unpersuaded of the need to ease up on austerity to stimulate growth and avoid a social upheaval in countries where half of young people have no work. Jack Lew, the US Treasury secretary, Christine Lagarde, head of the International Monetary Fund, and European Commission president Jose Manuel Barroso are among those who fear that austerity could bite in ways not anticipated by its promulgator.

Merkel's problem is that what is good for Germany may not be good for the rest of Europe. Her public acknowledgment that although other countries need a reduction in interest rates, Germany could use an increase if its growing economy is not to overheat, is taken as a hint to the ECB that she just might abide a tiny cut in interest rates at Thursday's meeting of its governing council. The betting is that the ECB will drop rates even though it is reluctant to appear to be endorsing Barroso's view that "austerity has reached its limits".

The problems in the eurozone are depressing US exports, which until now have been one of the drivers of the economic recovery: GE's industrial sales to Europe are down 17%. And the fall in China's growth rate — to 7.7% — is cutting its demand for commodities, which in turn is causing a drop in sales of American-made mining machinery: Caterpillar reports that first-quarter sales in the Asia-Pacific region were down 24%.

All of which has produced the talk of another "spring swoon". Economists at the IMF, in the latest iteration of their forecasts, are now guessing that the American economy will not even achieve 2% growth this year: 3% will have to wait until 2014.

But be of good cheer, or at least better cheer. The consensus among economists here is that the IMF bunch and other swoon-mongers have it wrong. A panel of economists regularly surveyed by The Wall Street Journal is predicting that the economy will grow this year at a rate of 2.5%, sustaining the first-quarter pace, rather than swooning. That would bring full-year growth for 2013 to the fastest pace since 2005. The panel then expects growth to accelerate to 2.9% and 3% in the next two years.

My own sense is that the home-town boys have a better chance of being right than do the IMF economists. The revolution in energy availability and prices resulting from fracking technology is attracting manufacturing businesses to the US and, although that sector will never be as large as it once was, it will likely no longer exert a strong downward pull on economic growth.

The car boom seems certain to continue as consumers, scrimping on other things, continue to replace their ageing vehicles. And the housing recovery proceeds apace. My admittedly unscientific survey of property agents indicates that the March fall in sales of existing homes was due more to a lack of homes to sell than to a shortage of demand. In response, home builders are scrambling to augment supply: newly built homes for sale jumped in March to the highest level since late 2011. Sales of new homes last month were up 18.5% year-on-year, and prices up 3% in March alone. Home builders are complaining of difficulty in hiring skilled construction workers, and of the rising cost of building materials and land — hardly signs of inadequate demand.

With Ben Bernanke, the Federal Reserve Board chairman, and his colleagues administering the smelling salts of record low interest rates, cars and houses should help the economy to snap out of its swoon.

Irwin Stelzer is a business adviser and director of economic policy studies at the Hudson Institute; stelzer@aol.com